Office of Chief Counsel Internal Revenue Service

memorandum

CC:LM:MCT:CIN:1:TL-N-1580-01 JEKagy

date:

to: Will Jackson, Group 1362 Attn: Rick Ollendick

from: RICHARD E. TROGOLO
 Associate Area Counsel
 (Large and Mid-Size Business)

subject: NOL Utilization by

This memorandum responds to your request for assistance , concerning , a subsidiary of Your memorandum raised two issues for our consideration. Initially, having supplied us with two Closing Agreements executed by Appeals in regarding an earlier cycle, you queried whether the language in the Closing Agreements precluded the Service from challenging the taxpayer's use of a net operating carryforward. As a second matter, to the extent we believe that the language of the Closing Agreements does not preclude the Service from challenging the taxpayer's use of the net operating loss carryforward, you asked us to comment on the applicability of a "principal purpose standard" to the taxpayer's articulated business purpose for arranging its loss subgroups.

Each of the issues raised by your memorandum will be addressed separately. This memorandum addresses only the initial issue. As with other legal memoranda issued to any IRS office or employee, this memorandum should not be cited as precedent.

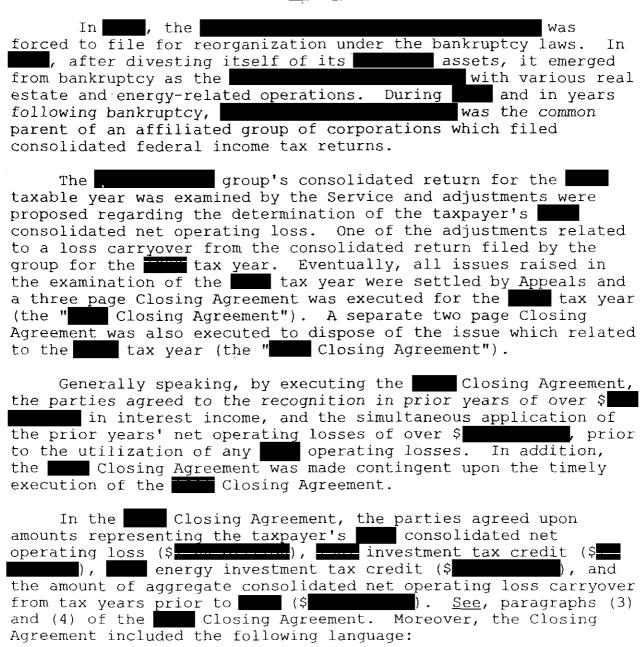
ISSUE:

Whether the two Closing Agreements, either individually or in conjunction, serve to preclude the Service from challenging the use of the taxpayer's net operating loss carryforward.

CONCLUSION:

We do not believe that the two Closing Agreements, either individually or in conjunction, prohibit the Service from challenging the use of the taxpayer's net operating loss carryforward in this instance.

FACTS:



The Commissioner shall not challenge, for carryback or carryover purposes, either the amount of the net

operating loss incurred by the Affiliated Group for taxable year or the status thereof as a consolidated net operating loss of the Affiliated Group.

See Closing Agreement, at ¶ (3).

In addition, paragraph (5) of the Closing Agreement also noted that the amount of the net operating loss carryover from years prior to (\$ (\$)) was "subject to any timely adjustments required by law." Paragraph (7) of the Closing Agreement made the agreement contingent upon the timely execution of the Closing Agreement.

From a historic perspective, in the early to midbecame a diversified company with interests in
businesses. Nevertheless, as
of , the group's NOL was still in excess of \$

By , ("") had
purchased a controlling interest ("%) in
Following the acquisition, the group
continued to file separate consolidated returns.

During the late s, began to divest itself businesses and later most of its of its also began businesses. During those years, to change its business structure. For instance, in completed the acquisition of all of the common stock was of engaged in the sale of in the State of California. Before the acquisition closed, already owned % of , and , which owned % of , owned an additional % of Moreover, principal shareholder was chairman of the board and chief executive officer of both and

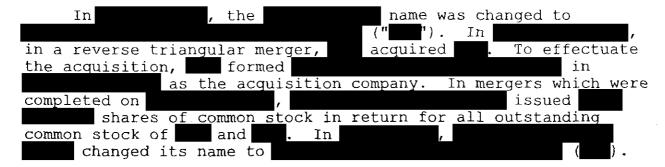
In also acquired three companies (the) from .

The consisted principally of and the business . These companies .

In subsidiaries of the sale of the remaining subsidiaries of the subsidiaries of the group, based upon its belief that shareholders by narrowing the focus of its operations."

That divestiture "virtually complete[d] the repositioning of the Company in the *** sector."

Parenthetically, the consolidated income tax returns for the through tax years of were not audited by the Service.



For financial accounting purposes, because the former shareholders of owned more than ... of following the mergers, the mergers were accounted for as a reverse acquisition, where was deemed to have acquired ... Following the mergers, and filed consolidated income tax returns which included all of or more owned U.S. subsidiaries. However, because of certain rights aggregating which were extended to holders of series and stock in connection with the mergers, continued to file a separate consolidated return.

The Service is currently examining the search taxable years of some some search to the issues being considered by the audit team is the utilization of the search net operating loss carryforward against the profits generated by the acquired search the Service's IDRs, the taxpayer has resisted supplying information about the potential NOL issue. The taxpayer's resistence appears based upon the taxpayer's belief that the search and closing Agreements preclude the Service from questioning any aspect of the NOL carryforward.

ANALYSIS:

Internal Revenue Code Section 7121(b) "Closing Agreements" provides:

FINALITY.--If such agreement is approved by the Secretary . . . such agreement shall be final and conclusive, and, except upon a showing of fraud or malfeasance, or misrepresentation of a material fact--

- (1) the case shall not be reopened as to the matters agreed upon or the agreement modified by any officer, employer, or agent of the United States, and
- (2) in any suit, action, or proceeding, such agreement, or any determination, assessment, collection, payment, abatement, refund, or credit made in accordance therewith, shall not be annulled, modified, set aside or disregarded.

meant to determine finally and conclusively a taxpayer's liability for a particular tax year. Hopkins v. United States, 146 F.3d 729, 732-33 (9th Cir. 1998). Yet, closing agreements are subject to ordinary principles of contract law and generally are interpreted under ordinary contract principles. See Rink v. Commissioner, 100 T.C. 319 (1993). Courts enforce the plain meaning of the agreement as drawn from its entirety. Silverman v. Commissioner, 105 T.C. 157, 166 (1995). Thus, if the essential terms of an agreement are deemed unambiguous, a court will not look beyond the four corners of the document to determine the parties' intent. See, e.g., Smith v. United States, 850 F.2d 242, 245 (5th Cir. 1988); P.J. Maffei Bldg. Wrecking Corp. v. United States, 732 F.2d 913, 916 (Fed. Cir. 1984).

We conclude, and we believe that any court undertaking a similar, independent reading of the closing agreements would find, that the closing agreements are clear and unambiguous. We believe that the plain meaning of the closing agreements, when read in their entirety, clearly reflects both the parties' agreement as to the amount and legitimacy of the losses incurred by the taxpayer and the parties' intent to preclude the Service from again questioning, at some later date, either the amount of those losses or the status of the losses so determined.²

In considering whether to raise the instant issue, the Service is not seeking to disturb the parties' agreement regarding the amount or status of the losses as determined by the closing agreements. If the Service decides to raised the potential adjustment, the Service will be questioning whether

Were a court to find a closing agreement ambiguous, the court would review any extrinsic evidence offered by the parties to determine the intent of the parties.

² However, it is also clear that the amount of the loss carryforward from years prior to was specifically subject to future "timely adjustments required by law."

losses, incurred by	or, may be absorbed by the
profits generated by the later a	acquired
The issue will turn on the nuand	ces of the consolidated return
	ne question of whether the NOL of
what used to be car	
	nired by from a subsidiary of
	one of scontrolling
shareholders. The amount or sub	ostance of the NOL carryforward
will not be at issue	

Based upon the foregoing, but without having yet opined on the strength of the consolidated return issue which you wish to consider, it is our opinion that you are not precluded by the and Closing Agreements from raising the consolidated return issue. In the future, if we favorably opine on the legitimacy of the potential consolidated return issue and the taxpayer fails to produce the factual information necessary to the determination of whether the consolidated net operating loss may be offset against the income of the recently acquired , then we will assist you in the preparation, issuance and enforcement of summonses to obtain the necessary information.

DISCLOSURE STATEMENT

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney client privilege. If disclosure becomes necessary, please contact this office for our views.

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By:____

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